United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL

77-7232

To be argued by
HARRY E. YOUTT

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P/S

United States Court of Appeals
FOR THE SECOND CIRCUIT

HERBERT FEDERMAN et al.,

Plaintiffs,

against

EMPIRE FIRE AND MARINE INSURANCE COMPANY et al.,

Defendants-Appellees,

and

STUART C. GOLDBERG and JACOB ASCHKENASY,

Additional Defendants on Cross-Claims,

STUART C. GOLDBERG,

Additional Defendant on Cross-Claims, Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES COURT OF APPEALS
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SECOND CIRCUIT

APPELLANT'S REPLY BRIEF

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UNITED STATES COURT OF APPEALS
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ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

APPELLANT'S REPLY BRIEF

PRELIMINARY STATEMENT

This brief is submitted in reply to some of the

matter contained in appellees' answering briefs. Since there is much repetition of argument between and among the three sets of appellees ("Empire", "Law Firm" and "Aschkenasy"), and in order to conserve the Court's time, this argument in reply will be directed principally to points raised in the Empire brief.

ARGUMENT

I. APPELLEES MISCONCEIVE THE BASIS FOR "ARISING UNDER" JURISDICTION FOR GOLDBERG'S CLAIMS

The basis of Goldberg's invocation of federal question jurisdiction is two-fold: (1) his properly-pleaded, state-created claims require interpretation of the federal securities laws -- indeed Goldberg cannot recover unless he proves the same basic allegations as are tendered by the typical 10b-5 plaintiff; and (2) this case presents, perhaps for the first time, important policy questions concerning the ethical duties of attorneys involved in securities transactions, which questions call for uniform federal answers. While fully conceding in his main brief that these claims do not seek a remedy "expressly granted" or "otherwise inferred" from the securities laws (p.16), Goldberg maintains that federal principles should govern their disposition.

Appellees have failed to address this aspect of the "arising under" test for federal jurisdiction. They have emphasized instead that the Securities Exchange Act of 1934 cannot

be invoked by one who is not a buyer or seller of securities. (Empire brief p.16). Goldberg, as noted, does not quarrel with this proposition. As for Goldberg's argument for 28 U.S.C. § 1331 jurisdiction of his state law claims based on the T.B. Harms - McFaddin Express - Ivy Broadcasting rationale, appellees cite two inapposite authorities.

The first is Santa Fe Industries, Inc. v. Green, ___ U.S. ____ , 97 S.Ct. 1292 (1977). The issue in Santa Fe was whether majority shareholders violated Rule 10b-5 in connection with a Delaware short-form merger where the minority claimed breach of the fiduciary duty of fair dealing. The merger was effected in accordance with Delaware law, which required neither a business purpose nor prior notice. The minority shareholders also claimed that their shares were grossly undervalued, and that this, too, constituted a fraud actionable under Rule 10b-5. The Supreme Court held that Rule 10b-5 reaches only those frauds accomplished by "deceptive" or "manipulative" devices; a claim is not stated where disclosure is full and fair, and the plaintiff is complaining simply of the terms of the transaction. The plaintiffs in Santa Fe were free to reject the merger price and apply in Delaware Chancery Court for an appraisal.

Moreover, the Santa Fe Court was being asked in effect to substitute a "federal fiduciary principle" under 10b-5 for established state corporate fiduciary standards:

> [W]e are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden. 97 S.Ct. at 1304

Three Justices declined to join in this concluding portion of the Court's opinion. Even as it stands, Santa Fe clearly does not address the question of whether admittedly state law claims "arise under" the federal securities laws. The issue rather is whether a claim under Rule 10b-5 is stated. Here, Goldberg does not ask the Court to "federalize" transactions which state law has attempted to regulate. Instead, he asks the Court to affirm federal jurisdiction of state law claims which require interpretation of the federal statutes and which import momentous questions concerning the lawyer's role in fostering the full and fair disclosure that lies at the heart of federal securities policy.

Again, appellees cite Cort v. Ash, 422 U.S. 66 (1975), for the criteria to determine whether there is a "federal cause of action" (Empire brief, p.17). But that is not the issue here.

The issue under 28 U.S.C. § 1331, is whether Goldberg's claims require "construction of an Act of Congress" or whether "a distinctive policy of an Act of Congress requires that federal principles control the disposition" of Goldberg's state law-based claims. Ivy Broadcasting Co. v. A T & T, 391 F.2d 489, 493 (2d Cir. 1968). For the reasons stated at Point II of Goldberg's main brief, we submit that both questions should be answered in the affirmative.

II. APPELLEES FAIL TO REBUT THE ARGUMENT THAT ANCILLARY, NOT PENDENT, JURISDICTIONAL PRINCIPLES APPLY TO GOLDBERG'S STATE LAW CLAIMS

Only the Empire defendants attempt to deal with the ancillary jurisdictional analysis set forth at Point III of Goldberg's main brief. (See Empire brief, Point II). The distinction between the pendent jurisdiction doctrine as set forth in United Mineworkers v. Gibbs, 383 U.S. 715 (1966), and the broader (and different) doctrine of ancillary jurisdiction, under which this case should have been decided, appears to have escaped even Empire, judging from the latter's scattergun assortment of objections.

Empire asserts that Goldberg's claims do not arise out of the transaction or occurrence that is the subject matter of Empire's claims against Goldberg, and that therefore they are not compulsory counterclaims as defined by Rule 13(a), Fed. R.Civ.P. (Empire brief, p.19). Empire's claims against Goldberg (24a-28a) sound in negligence and malpractice in the preparation of the Empire registration statement. Goldberg's claims against Empire (149a-167a) sound in "injurious involvement" and fraud in connection with the preparation of the same statement. It is hard to imagine a more obvious example of claims arising from the same transaction or occurrence.*/ As

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*/ The fact that some of Goldberg's damages were incurred long after the preparation of the statement, stressed by Empire (Empire brief, p. 19), is plainly irrelevant to the question of whether the claims arose from the same state of events.

such, Goldberg's claims against Empire are plainly compulsory counterclaims.

O'Connell v. Erie Lackawanna R.R. Co., 391 F.2d 156 (2d Cir. 1968), vacated as moot, 395 U.S. 210 (1969), is clearly distinguishable. There, the plaintiff claimed that union shop clauses in a collective bargaining agreement violated the Railway Labor Act. Defendant counterclaimed for libel based on published remarks of plaintiff concerning the defendant's union. This Court held the counterclaim permissive, since it "does not arise out of the same transaction or occurrence as appellees' claim." 391 F.2d at 163. The facts are not reported in detail, but it appears that the alleged libelous reference to the union as a "dictatorship" was not logically related to the issues concerning the union shop agreement and the Railway Labor Act.

Here, on the other hand, Goldberg's claims arise directly from the occurrences that underlie both the original securities claims of the plaintiffs and Empire's subsequent claims against Goldberg. Goldberg's Amendment to his Amended Answer sets forth at great length the scheme to violate reporting requirements entered into by the Law Firm and Empire defendants, culminating in a fraudulent Registration statement. ¶¶41a-59a (150a-159a). The registration statement lay at the heart of the original plaintiffs' claims (Complaint, 6a-15a), as well as Empire's claims against Goldberg and others (24a-28a). All of Goldberg's damages flow from the same source:

> ¶60a. As a direct and immediate consequence of the aforedescribed scheme by the Law Firm defendants and Empire defendants to violate the Securities laws by failing to disclose the finder's fee and conditional stock purchase by the Law Firm in the Empire Registration Statement, Professor Goldberg has suffered substantial injury and damage in the following respects:
>
> [extensive damage claims follow]
>
> (160a).

Indeed, all the claims asserted in this action since the beginning have arisen out of the same alleged fraudulent conduct. Empire alleged Goldberg was at fault; Goldberg countered that Empire fraudulently involved him in the scheme. As to Empire, Goldberg's claims are clearly compulsory counterclaims.

Empire next argues that, since Goldberg's claims respond to Empire's state law-based cross-claims "and not to the federal claims of the plaintiff," Goldberg's claims "stand on no better jurisdictional footing than Empire's cross-claims." (Empire brief, p.20). The short answer to this is that Goldberg's claims surely stand on no worse jurisdictional footing, either. Empire's claims, arising from the same transactions as plaintiff's main claims, need no independent jurisdictional basis; Goldberg's claims, being compulsorily counter to Empire's, similarly require no independent basis. As we have argued, both sets of claims are supported by those principles of ancillary jurisdiction which enable a federal court to deal with the entire controversy before it, "regardless of the money involved, the citizenship of the parties, or the existence of a federal question in the ancillary suit." 1 Moore's

Federal Practice ¶ 0.90[3]. (See App. brief, pp.25-27). Indeed, it would be remarkable if the rule were otherwise, since Empire's cross-claims were permissive under Rule 13(g), while Goldberg's counterclaims were compulsory under Rules 13(a) and 14(a).

Empire attempts further to muddy the waters by arguing that its claims were asserted via Rule 13(h), not as third-party claims under Rule 14. Assuming arguendo that Goldberg was brought into this suit via 13(h), rather than as a third-party defendant,*/ the significance of this distinction is nowhere revealed by Empire, although the latter asserts that it affords a basis for disregarding Goldberg's authorities on the survival of ancillary jurisdiction. (Empire brief, p.21). We maintain, on the contrary, that the ancillary jurisdiction considerations are the same regardless of how the question of joinder is conceptually characterized.

In the first place, however viewed, Goldberg's claims remain compulsory counterclaims as to Empire and cross-claims as to the Law Firm defendants and Aschkenasy.**/ The nature

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*/ The situation can be viewed either way. Empire's service of summons and cross-claims on Goldberg may be seen as an attempt to make a non-party a party to those cross-claims (Rule 13(h)), or as an attempt to bring in "a person not a party to the action who is or may be liable to [Empire] for all or part of the plaintiff's claim against [Empire]." (Rule 14(a))

**/ And the appellees have so characterized them. See Law Firm defendants' "Answer to Cross-Claim" (61a-64a); Empire defendants' "Reply to Counterclaim" (59a-60a, 65a-66a).

of the claims, and whether they must or may be asserted depends on Rules 13(a) and 14(a), and the result under either is the same:

> A third-party defendant in any case may, and in the compulsory counterclaim situation must, assert a counterclaim against the third party plaintiff, and may cross-claim as provided in Rule 13. An additional defendant, brought in under Rule 13(h), should also be within and subject to the terms of Rule 13 relative to counterclaims and cross-claims.

3 Moore's Federal Practice ¶ 13.05, p.13-108 (footnotes omitted).*/

By the same token, the ancillary basis of the claims is unaffected by the manner in which the parties are joined. Empire argues that, once the plaintiffs' action was settled, the Court had "discretionary pendent jurisdiction" over Empire's cross-claims and, presumably, over Goldberg's counter- and cross-claims. (Empire brief, p.20). The authorities cited by Empire, however, do not support this conclusion. Although 3 Moore's Federal Practice ¶ 13.36, p.13-929 uses the phrase "discretionary pendent jurisdiction," the discussion immediately

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*/ See also id. ¶ 14.17, where the following illustration appears at p.14-379:

> A.B. brings suit against C.D. who impleads E.F. E.F. must counterclaim against C.D. in the situation governed by Rule 13(a), since C.D. and E.F. are "opposing" parties within the meaning of Rule 13.

preceding that phrase makes clear that the author's meaning coincides with Goldberg's position here:

> Cross-claims, like all cross-bills, and like compulsory counterclaims are considered as auxiliary or ancillary to the principal claim to which they are related, and the jurisdiction which supports that claim will support the cross-claim. . . .
>
> * * *
>
> If the original bill or claim in connection with which the cross-claim arises is dismissed for lack of jurisdiction, it would seem, on analogy to cases concerning counterclaims, that the dismissal carries with it the cross-claim, unless the latter is supported by independent jurisdictional grounds. In the compulsory counterclaim cases, however, where the original bill was dismissed on the merits or the opposing party did not proceed to hearing on his bill jurisdiction over the counterclaim was sustained even though independent jurisdictional facts did not exist for its support. These same principles should apply to sustain jurisdiction over the cross-claim under similar circumstances, even though the cross-claim is permissive, since there is jurisdiction over the main action and the cross-claim is auxiliary or related to the main action.

Id., pp.13-925 - 13-929 (footnotes omitted).

In fact, it is the appellees who cite no authority for what must be their central contention: namely, that where the main claim is settled (not dismissed on jurisdictional

grounds), claims ancillary thereto ought to be dismissed. Ramey v. Cincinnati Enquirer, Inc., 508 F.2d 1188, 1200 (6th Cir. 1974), cert. denied, 422 U.S. 1048 (1975), cited at p.21 of Empire's brief, merely affirms the District Court's refusal to entertain "pendent jurisdiction" of a cross-claim for attorney's fees; no discussion appears in the opinion. Mayer v. Chase National Bank, 165 F.Supp. 287 (S.D. N.Y. 1958), also cited by Empire, is contra Empire's position. There, the Court retained ancillary jurisdiction over a state law cross-claim asserting title to a certain fund, where the main claim, based on diversity of citizenship, had been dismissed. This holding was affirmed by the Court of Appeals, sub nom. R.M. Smythe & Co. v. Chase Nat. Bank of City of New York, 291 F.2d 721 (2d Cir. 1961), on the basis that

> the cross-claim was sufficiently related to the main claim so as to be considered ancillary to it and, therefore, an independent jurisdictional basis for the cross-claim was not required. Id. at 724.

Empire would distinguish the cases cited by Goldberg on the basis that some involved third-party claims and others involved compulsory counterclaims to federal main claims. Empire cites no case, because there is none, holding that compulsory counterclaims responding to federal claims stand on stronger ancillary footing than other compulsory counterclaims; Empire cites no case holding that "third party" claims stand on stronger ancillary footing than claims against "additional"

parties. This Court and others have rejected such distinctions. See, e.g., Lesnik v. Public Industrials Corp., 144 F.2d 968, 974 (2d Cir. 1944); United Artists Corp. v. Masterpiece Prods., 221 F.2d 213 (2d Cir. 1955); H.L. Peterson Co. v. Applewhite, 383 F.2d 430 (5th Cir. 1967). Hence, the ancillary analysis set forth in Goldberg's main brief remains unrebutted.

This analysis is ignored by the appellees in their Gibbs arguments. As our main brief made clear, Gibbs dealt with true pendent jurisdiction: a plaintiff seeking to join a state claim to his federal claim. That is not even remotely the case here. Therefore, the cases cited by Empire at pages 21-23 of its brief totally miss the mark. In all of those cases, plaintiff sought to pend state claims to federal ones. Here, Goldberg was brought against his will into what was clearly a federal suit, and he was required by the Rules to assert what claims he had arising out of the subject matter of that suit. He does not seek "to impose upon [the Court] what is in effect only a state law case." Gibbs, supra, 383 U.S. at 727. Rather he contends that, ancillary jurisdiction having long ago attached, he is entitled to see his claims through to conclusion in the federal forum.

Empire suggests that it was proper to stay this action "pending resolution of difficult state law problems by the state courts" (Empire brief, p.23). The abstention doctrine requires more than is present here for the court to stay its

hand. See Colorado River Water Conservation Dist. v. United States, ___ U.S. ___ , 96 S.Ct. 1236 (1976), where the narrow grounds for abstention are held to be (1) where plaintiff seeks to restrain state proceedings, (2) where a federal constitutional issue might be mooted by resolution of a state law issue, or (3) where there are

> difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result in the case then at bar. Id. at 1244

These circumstances certainly do not obtain in the present case. Moreover, the cases cited by Empire*/ all involved claims that were already pending in the state courts (Delaney, Reichman) or could easily have been raised in long pending actions (Rosensteil). In addition, Rosensteil involved questions under New York marriage laws which are uniquely committed to state tribunals and with which "federal judges are more than ordinarily unfamiliar." 490 F.2d at 515. Similarly, Reichman concerned interpretation of a state's estate and trust laws.

Finally, the state law governing Goldberg's claims is clear, for the most part settled, and does not require the special expertise of state tribunals heretofore uninvoked. (App. brief, pp. 45-51; see also Point III, infra).

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*/ Phillips, Nizer, etc. v. Rosensteil, 490 F.2d 509 (2d Cir. 1973); Reichman v. Pittsburgh Nat'l Bank, 465 F.2d 16 (3d Cir. 1972); United Services Life Ins. Co. v. Delaney, 328 F.2d 483 (5th Cir.), cert. denied, 377 U.S. 935 (1964).

III. GOLDBERG'S CLAIMS ARE NOT OF "QUESTIONABLE SUFFICIENCY" UNDER NEW YORK LAW, NOR DO THEY PRESENT ISSUES SO NOVEL OR COMPLEX AS TO JUSTIFY DECLINING THE EXERCISE OF JURISDICTION

One of Empire's more breathtaking assertions is that "pendent" jurisdiction should not be exercised here because of the "questionable sufficiency of Goldberg's claims under New York law." (Empire brief, p.25). Appellees' motions to dismiss below may have tendered the question of the sufficiency of Goldberg's claims, but whether or not pendent jurisdiction should be exercised certainly does not turn on the sufficiency vel non of the state claims. Empire's position would turn every pendent jurisdiction problem into a kind of preliminary motion to dismiss for failure to state a claim. It would lead to the anomalous result that jurisdiction turns on the sufficiency vel non of one's claims. None of the appellees have cited any authorities for this odd notion. Indeed, appellees appear to have confused the different principle that, where the federal claim is frivolous, state claims pendent to it must generally fail. See, Nolan v. Meyer, 520 F.2d 1276 (2d Cir.), cert. denied, 423 U.S. 1034 (1975).*/

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*/ Nolan is cited by Empire (p.23) for the proposition that "since the issues raised by Goldberg are without precedent in New York," it might have been error to retain them. Nothing in Nolan suggests such a rule.

The question before this Court is whether, assuming pendent jurisdiction analysis applied at all, the Court below erred in relying on the "complexity and novelty" of the state law issues to refrain from deciding them, in view of the special circumstances favoring decision (App. brief, pp.41-45). At any rate, Goldberg's state law claims are clearly adequate (Id., pp. 45-51), and the objections raised here by appellees are without merit.

Empire continues to characterize Goldberg's claims as virtually identical to that in Morrison v. NBC, 24 A.D.2d 284 (1st Dept. 1965), rev'd, 19 N.Y.2d 453 (1967). (Empire brief, p.25) This case is actually more akin to Horstein v. General Motors Corp., 391 F.Supp. 1274 (S.D. N.Y. 1975) and Seidel v. Greenberg, 108 N.J.Super. 248, 260 A.2d 863 (1969), cited at p.49 of our main brief, in that here many elements of damages were sustained, not simply the general reputational damage suffered in Morrison. Moreover, the broad basis in New York law for recovery from this type of tort has long been recognized (App. brief, pp.48-50).

Empire states that only special damages can be recovered under this tort. This is, of course, untrue, and the cases cited by Empire (pp.25-26) are not injurious involvement cases, but cases in defamation or prima facie tort. The theory of these cases is that, where damage cannot be presumed to flow from a certain wrong as of course, the manner in which injury was sustained must be pleaded. In short, the plaintiff must show that he was actually damaged.

Here, general damages are recoverable, since Goldberg pleads injury to his reputation, and this is the type of harm that may logically be expected to flow from defendant's involvement of Goldberg in their fraud. If appellees insist on analogizing this case to defamation, then the analogy is plainly to defamation per se, since the direct result of defendant's scheme was to injure Goldberg's reputation as a lawyer (160a-165a). Special damages need not be pleaded under such circumstances. See, e.g., Kleeberg v. Sipser, 265 N.Y. 87, 91 (1934); Buckley v. Littell, 394 F.Supp. 918, 941 (S.D. N.Y. 1975) modified, 539 F.2d 882 (2d Cir. 1976); Arizona Biochemical Co. v. Hearst Corp., 302 F.Supp. 412 (S.D. N.Y. 1969).

Although special damages are not necessary to Goldberg's claims, he did plead them, and in detail. The pleading requirements for recovery of such damages were met. Fed. Rules Civ. P. Rule 9(g) provides that items of special damage "shall be specifically stated."

> [I]f the plaintiff has a cause of action regardless of whether or not he has suffered special damage, no particularity is required. In this case the special damage is superadded to the general damages which flow from the statement of the cause of action, and although a specific statement is necessary in order to recover for the special damage, it can easily be made. 2A Moore's Federal Practice ¶ 9.08, pp.1975-1976.

See also 3 Weinstein, Korn & Miller, New York Civil Practice ¶ 3015.19, p.30-307, where it is noted that, where special damages are sought in addition to general damages,

> the court should be concerned only with whether the pleading properly apprises the opposing party of the elements of damage claimed by the pleader and enables him to prepare his defense.

In his Amendment to Amended Answer, Goldberg pleaded his special damages in great detail. These include: loss of employment as a securities attorney (¶ 60a(i); 160a-161a); expenses in connection with the SEC investigation (¶60a(v); 162a), the bar association grievance investigation (¶60a(vi); 162a), and civil litigation (¶60a(vii), (viii); 162a-163a); and medical expenses (¶60a(x); 164a-165a). In the remainder of ¶60a, Goldberg has pleaded his general damages, also in great detail. He has listed with as much specificity as possible the dollar amounts of his damages, including legal fees, loss of income (past and prospective), injury to professional and personal reputation, mental and emotional pain and suffering, medical expenses, and physical pain and suffering.

Certainly neither New York nor Federal requirements demand more detailed pleading of damages than this. Indeed, even if Goldberg were not entitled to general damages for injury to his reputation, the special damages he has itemized would support the cause of action and render general damages recoverable under the defamation analogy stressed here by appellees.

> . . . once the cause of action is established, either by the character of the defamation itself or by the proof of pecuniary loss, the bars are lowered, and "general" damages may be recovered for the injury to

> the plaintiff's reputation, his wounded feelings and humiliation and resulting physical illness and pain, as well as estimated future damages of the same kind. In other words, such damages are insufficient in themselves to make the slander actionable, but once the cause of action is made out without them, they may be tacked on as "parasitic" to it. Prosser, Torts § 112, p.761 (4th ed. 1971) (emphasis added).

Unable forthrightly to confront the fact that Goldberg has pleaded both general and special damages, and is entitled to recover both, the Empire defendants turn to more desperate arguments. They claim that the figure of $16,187, representing Goldberg's loss of employment with the Sitomer firm during the remaining term of his contract, is based on no facts. (Empire brief, p.26) Yet, the first record passage cited by Empire (342a-344a) shows very clearly how this figure was determined.

Empire also argues (Empire brief, p.27) that Goldberg's medical expenses for psychiatric treatment are not allowable because Goldberg visited a psychiatrist prior to the events involved here! This ridiculous argument is akin to saying that a claim for injuries in an automobile accident should be dismissed if the plaintiff has ever visited a doctor for treatment prior to the accident.

Empire (p.27) also attacks the recoverability of attorney's fees, and cites the general New York rule that such fees, as incidents of present litigation, are ordinarily not compensable. But Goldberg's claims come within a different rule:

> If, through the wrongful act of his present adversary, a person is in-

> volved in earlier litigation with a third person in bringing or defending an action to protect his interests, he is entitled to recover the reasonable value of attorneys' fees and other expenses thereby suffered or incurred [citations omitted]. Shindler v. Lamb, 25 Misc.2d 810, 211 N.Y.S. 2d 762, 765 (S. Ct. 1959).

Similarly, in Fugazy Travel Bureau, Inc. v. Ernst & Ernst, 31 A.D.2d, 924, 298 N.Y.S.2d 519 (1st Dept. 1969), a case involving allegedly reckless and fraudulent conduct, leave to amend plaintiff's complaint so as to add a claim for attorneys' fees was held properly granted:

> If the alleged wrongful act of the defendant was the occasion of these fees, and if they are reasonable, a cause of action does lie. . . . 298 N.Y.S.2d at 520.

It is of the very essence of Goldberg's claim here that defendants' wrongful acts occasioned his expenditure of attorneys' fees in order to defend himself against the threatened and actual litigation of third parties. Defendants' invocation of the rule denying counsel fees as damages in the litigation to which they are incident simply misses the point, as the following partial citation of authority makes clear: Worden v. Davis, 195 N.Y. 391, 88 N.E. 745 (1909); Watson v. City of New York, 57 Misc.2d 542, 550, 293 N.Y.S.2d 348 (S. Ct. 1968); Cooper v. Weissblatt, 154 Misc. 552, 277 N.Y.S. 709, 719 (S. Ct. App. Term 1935); Gale v. Ryan, 263 App.Div. 76, 31 N.Y.S.2d 732 (1st Dept. 1941); Penn-Ohio Steel Corp. v. Allis-Chalmers Mfg. Co., 7 A.D.2d 441, 184 N.Y.S.2d 58 (1st Dept. 1969); Horstein v. General Motors Corp., 391 F.Supp. 1274 (S.D. N.Y. 1975); Seidel v. Greenberg, 108 N.J. Super. 248, 260 A.2d 863 (1969). See cases collected in Annot., 21 A.L.R.3d 1068.

Defendants' argument also evinces a very short memory. In paragraphs 39-41 of the Empire defendants' answer and cross-claims (Third cross-claim) (27a), a claim for attorneys' fees directly analogous to Goldberg's claim -- and growing out of the same facts -- is made, to wit:

> "AS A THIRD CROSS-CLAIM AGAINST THE SITOMER FIRM, ALVIN L. SITOMER, STEPHEN J. SITOMER, ROBERT E. PORGES, STUART C. GOLDBERG AND JACOB ASCH-KENAZY, ALLEGE:
>
> 39. The allegations contained in paragraphs 27 through 35, inclusive, of this answer are incorporated by reference.
>
> 40. In connection with the registration statement and prospectus prepared and filed by the Sitomer firm, its partners and Aschkenazy, Empire and defendant Gary O. Gross ("Gross") have been subjected to legal and administrative proceedings and have thereby incurred substantial expenses, including attorneys' fees, as a result of the negligence and malpractice of the Sitomer firm, its partners and Aschkenazy.
>
> 41. By reason of the foregoing, Empire and Gross have sustained damages in the sum of $150,000 and are entitled to reimbursement from the Sitomer firm, its partners and Aschkenazy for these expenses."

Thus, the dispute here, in all frankness, is not over whether attorneys' fees are recoverable, but rather who is liable for them. Defendants are entitled to plead in the alternative, but resort to mutually exclusive interpretations

of a single point of law in support of such alternatives seems to strain the principle a bit. If defendants wish to assert that attorneys' fees are not a cognizable element of special damages, then the least they could be expected to do is offer to withdraw their claim for counsel fees. As for Goldberg, he will, with all due respect, stand by the authorities here cited.

Empire's objections to the damage elements comprising prior judicial and administrative proceedings and published commentary thereon (Empire brief, pp. 27-29) totally misconceive the fact that these are, in fact, elements of damage, not distinct causes of action. Goldberg's claims are not based on these prior proceedings. Rather, he alleges that defendants' fraudulent involvement of him in the securities fraud they perpetrated proximately resulted in all of Goldberg's damages, including those attributable to judicial and administrative proceedings and attendant publicity. No state or constitutional privilege immunizes these defendants from liability for all the damages proximately resulting from their wrongful acts.*/

---

*/ Empire would have the pleading dismissed for failure to "establish that the alleged damage to . . . reputation was the direct and proximate consequence of Empire's acts." (Empire brief, p.29) Obviously, "establishing" such causation is a matter for trial. For now, it suffices to point out that each element of damage bears a natural and foreseeable relation to defendants' torts. It is certainly foreseeable that a respected securities lawyer, author of many publications on securities law and ethics, would suffer the kind of damages here alleged should he be "involved" by the fraud of others in securities violations of this proportion.

Empire continues the litany by attacking Goldberg's damage claims in the fraud counts. (Empire brief, p.30) Empire's resort to commercial fraud cases misses the mark. Our main brief makes clear that consequential damages may be awarded in a proper fraud case, and that relief is not limited to pecuniary, out-of-pocket loss (App. brief, pp.47-48).

Predictably, appellees have directed the bulk of their attack on the sufficiency of these claims to the "injurious involvement" claim. We believe ample New York authority supports this cause of action. In addition, Goldberg has set forth traditional claims in fraud and breach of warranty which comprise straightforward, hornbook allegations. If pendent jurisdiction requires strong state law claims, they have been adequately supplied. Certainly there is nothing so novel or complex here as to justify requiring that these claims be transferred to the state courts.

IV. JUDGE MacMAHON'S PRIOR ETHICS OPINION IS PROPERLY AN ELEMENT OF THE DAMAGES GOLDBERG SEEKS AGAINST THESE DEFENDANTS

Finally, a brief word as to the recusal application. Appellees misconceive the role of Judge MacMahon's ethics decision in this matter. Empire, for example, at p.33 of its brief, sets forth the truism that the opinion is "privileged" and "may not be the basis of a lawsuit for alleged damage to reputation." However, the opinion is not the basis for this lawsuit; Goldberg is not suing Judge MacMahon. He is claiming that a proximate consequence of the wrongful acts of these

defendants was the writing of the ethics opinion, and that, because the opinion was unfortunately incorrect, it exacerbated the reputational and other damages sustained by Goldberg. The question is ruled, not by privilege, but by principles commonly applied to cases of malicious prosecution, or cases where fraud or other wrongdoing causes one to initiate or defend lawsuits in order to protect his rights. (See the authorities cited, supra, pp. 18-19). A proximate result of these defendants' fraud on Goldberg, their injurious involvement of him in their securities fraud, was Goldberg's involvement in legal proceedings in which his ethics were brought into question. Judge MacMahon's opinion, until reversed by this Court, stood as a cloud over Goldberg's professional reputation. Thus, privileged or not, the opinion and its ramifications are a very real element of the damages that Goldberg can and does seek against these defendants. As such, the opinion creates serious problems for Judge MacMahon's presiding over the trial of these damage claims, as outlined in our main brief, pp.51-65.

CONCLUSION

For the foregoing reasons, appellant respectfully renews his request for judgment reversing the orders below.

Respectfully submitted,

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United States Court of appeals
for the Second Circuit

Herbert Federman et al.,
Plaintiffs,
against
Empire Fire and marine Insurance Company et al.,
Defendants-Appellees,
and
Stuart C. Goldberg and Jacob Aschkenasy,
Additional Defendants on Cross-Claims,

Stuart C. Goldberg,
Additional Defendant on Cross-Claims,
Appellant.

AFFIDAVIT OF SERVICE

STATE OF NEW YORK,
COUNTY OF NEW YORK, ss.:
James Jenkins

, being duly sworn, deposes and says that he is over the age of 18 years, is not a party to the action, and resides at 2331 Seventh Avenue, New York, New York

That on October 31, 1977, he served 2 copies of Reply Brief on

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116 John Street,
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D'Amato, Costello & Shea,
by: Robert E. Meshel, Esq.,
116 John Street,
New York, New York, 10038.

by delivering to and leaving same with a proper person or persons in charge of the office or offices at the above address or addresses during the usual business hours of said day.

James Jenkins

Sworn to before me this
31st day of October, 1977.

John V. D'Esposito

JOHN V. D'ESPOSITO
Notary Public, State of New York
No. 30-0932350
Qualified in Nassau County
Commission Expires March 30, 1979